Factsheet – Onshore Bond

What is an Investment Bond?

An investment bond is a single premium non-qualifying 'whole of life' assurance contract that has a substantial investment component. The life assurance element is minimal and typically will pay between 100% and 101% of the current value on the death of the life assured. The value of the contract will be based on the investments held within the investment bond.

The investment bond is effectively a 'tax wrapper'. Within this 'wrapper' you can select individual funds to invest into and switch between funds without any immediate tax consequences. The actual range of funds available will depend on the investment bond provider.

An insurance bond is a 'non-incoming producing asset'. This simply means that, as far as HMRC are concerned, the investment bond does not produce any income but only capital growth.

A chargeable event

Investments are subject to income tax and a tax liability may arise whenever there is a chargeable event. A chargeable event is triggered on:

- Death of the life assured (or last to die of lives assured) where benefits are payable
- Assignment (full or in part) for money or money's worth
- Maturity of the policy
- Partial or regular withdrawals across a whole bond, in Excess of the 5% tax deferred allowance
- Surrender of the bond, whether in full or surrender of clusters

The amount of tax you pay will depend upon your income tax rate.

There are 2 types of investment bonds:

1. Life Assured Bond – a life assurance bond must have a life assured or lives assured. It can be set up with:

    a. single or joint owners - with a single life assured or with joint lives assured on either a first death or last survivor basis
    b. on an own life or life of another basis - with a single life assured or with joint lives assured on either a first death or last survivor basis
    c. or with multiple lives assured.

    The bond will have to come to an end when the last of the lives assured dies. The lives assured does not necessarily need to include the policyholder.

2. Capital redemption bond – with a capital redemption bond, there are no lives assured and therefore, the bond does not need to come to an end due to death. They do however have a maximum term of 99 years.

Most investment bonds are written as a series of identical policies or segments and each segment is treated as a separate policy in its own right. This allows flexibility when withdrawing lump sums.

Withdrawals and the 5% tax deferred allowance

All investment bonds have a '5% tax deferred allowances'. The 5% tax deferred allowance means that you can take an 'income' of up to 5% of the original investment each year without any immediate liability to tax, or having to declare anything on your tax return. This can be done for up to 20 years and the logic behind this rule is that the HMRC considers the 5% tax deferred allowance to be the repayment of your original capital rather than any income or gain as such.

You can also carry forward these 5% tax deferred allowances each year. For example, you can leave the bond untouched for 5 years and then take 25% of the original investment without any immediate tax charge at that time. Please note the 5% tax deferred allowances refer to 5% of the *original* investment, not 5% of the value of the bond at the time.

Withdrawals in excess of 5% per year will trigger a chargeable gain event and there is an immediate potential tax liability.

Any ongoing adviser fees will utilise part of this 5% allowance.

Withdrawals

There are three ways of withdrawing lump sums from an investment bond:

1. Partial surrender across all of the segments held within the bond – if the amounts withdrawn are within the 5% tax deferred allowance, then there is no immediate liability to tax.
2. Full encashment of whole segments held within the bond – this gives rise to a chargeable event and a potential liability to tax. This also reduces the 5% tax deferred allowance available in future as the number of segments will be reduced.
3. Combining both methods

Assignment

An investment bond, or any of its segments, can be assigned. An assignment is a change of ownership of an investment bond (or its segments); the change of ownership has to be supported by a legal document – a deed of assignment.

The assignment has to be outright and unconditional. Provided it is not for money or money's worth, it does not trigger a chargeable event and does not give rise to an income tax charge. Subsequent chargeable event gains are assessed on the assignee (new owner).

How Gains are taxed

Income tax is only potentially payable when a chargeable event has occurred. Capital Gains Tax does not apply to policy holders.

A key feature of an investment bond is that when investments are changed within the bond wrapper, there is no liability to tax for the policy holder.

Income tax and capital gains tax are paid within the fund at a rate equivalent to the basic rate tax. The amount of additional tax you pay will depend upon your income tax rate:

- Non-tax payer – there should be no further tax is payable unless the gains take you into becoming a higher or additional rate tax payer.
- Basic rate taxpayer – there should be no further tax payable unless the gains take you into the higher or additional rate tax band.
- Higher rate taxpayer – will pay a further tax at 20% tax on the gain, unless the gains take you into the additional rate tax band.
- Additional rate taxpayer - will pay further tax at 25% tax on the gain.

Investment bond holders may benefit from '**top-slicing relief**' which can help mitigate a higher rate or additional rate income tax liability arising as a result of a chargeable event gain being added to the taxpayer's total income.

Top Slicing

Top slicing relief is generally available where the taxpayer would be liable to tax at a lower rate were it not for the inclusion of the chargeable event gain in their income for the year. For onshore bonds it is only helpful if the full chargeable gain moves you into the higher or additional rate tax brackets when added to other income.

Where the gain does move you into the higher or additional rate, the gain is essentially sliced by the number of complete years the bond has been in force, unless the event is triggered by an excess event in which case you go back to the last excess event. The slice is then added to other income.

If, after the addition of this slice, you remain within the basic rate tax band then no further tax is due as the bond is deemed to have paid basic rate tax.

If, when the slice is added, you remain in the 40% tax bracket then 40% tax is paid on the whole gain.

If however the slices pushes you into the 40% or 45% bracket, a full top slicing calculation will need to be performed to determine the effective rate of tax that will be applied to the whole gain.

The calculation essentially follows a 5 step process and takes into account your income from all sources, the outcome of which will determine the level of tax due.

Whilst top slicing relief is available to mitigate a higher rate or additional rate income tax liability arising as a result of a chargeable event gain being added to the taxpayer's total income. It does not:

- Reduce income for the purposes of child or working tax credits (instead the full amount of the gain is included).

- Reduce income below £100,000 to preserve full entitlement to the personal allowance.
- Apply to personal representatives, corporate's or trustees. However, for the avoidance of doubt where a gain arises on a trust held policy and the creator is chargeable then that person would be eligible for top slicing relief. In contrast, where the creator is deceased or non resident and the trustees are non resident then a UK beneficiary receiving a benefit from the trust is taxable on that amount - if so, top slicing relief is not available.
- Apply to annual gains that arise on 'personal portfolio bond events.'